FILE COPY

IN THE

Supreme Court of the United States

OCTOBER TERM, [redacted] 1938

No. [redacted] 65

DOUGLAS FAIRBANKS,
Petitioner,

against

UNITED STATES OF AMERICA,
Respondent.

MOTION FOR LEAVE TO FILE PETITION FOR REHEARING OF PETITION FOR CERTIORARI AND PETITION THEREFOR.

ARTHUR F. DRISCOLL,
Counsel for Petitioner.

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No. 1069.

DOUGLAS FAIRBANKS,
Petitioner,

against

UNITED STATES OF AMERICA,
Respondent.

MOTION FOR LEAVE TO FILE PETITION FOR REHEARING OF PETITION FOR CERTIORARI.

MOTION FOR AN ORDER VACATING THE ORDER OF THIS HONORABLE COURT DATED OCTOBER 10, 1938, DENYING PETITION FOR A WRIT OF CERTIORARI.

MOTION FOR AN ORDER THAT THE ENTRY OF JUDGMENT IN THIS CASE BY THE DISTRICT COURT OF THE UNITED STATES FOR THE SOUTHERN DISTRICT OF CALIFORNIA, CENTRAL DIVISION, BE STAYED UNTIL THE FINAL DETERMINATION OF THIS ACTION OR UNTIL FURTHER ORDER OF THIS HONORABLE COURT.

NOW COMES THE PETITIONER, Douglas Fairbanks, by his counsel of record, and moves this Honorable Court for the following relief:

I. For leave to file the attached petition for rehearing of the petition for a writ of certiorari to the Circuit Court of Appeals for the Ninth Circuit.

II. For an order vacating the order of this Honorable Court, dated October 10, 1938, denying the petition for a writ of certiorari.

III. For an order that the entry of judgment in this case by the District Court of the United States for the Southern District of California, Central Division, be stayed until the final determination of this action or until further order of this Honorable Court.

On October 17, 1938, this Honorable Court denied the petition for certiorari herein to the Ninth Circuit Court of Appeals, to review the decision of that Court, affirming a judgment of the United States District Court for the Southern District of California, Central Division, adjudging that the United States of America was entitled to recover income tax refunds alleged to have been made erroneously to Douglas Fairbanks for the calendar years 1927, 1928 and 1929 totaling $72,186.94, together with 6% interest from the date of payment of such refunds. The question of law involved is a construction of the meaning of the words "sale or exchange" of capital assets contained in Section 208(a)(1) of the Revenue Act of 1926 and Section 101(c)(1) of the Revenue Act of 1928.

On April 2, 1938, the Circuit Court of Appeals for the Ninth Circuit in this case held that the redemption of bonds prior to maturity by an issuing corporation did not constitute a "sale or exchange" of capital assets so as to entitle the holder thereof to be taxed at the remedial rate of 12½% upon the gains.

On December 28, 1938 (opinion filed January 6, 1939), the Circuit Court of Appeals for the First Circuit, in the case of

Frances M. Averill v. *Commissioner of Internal Revenue*, refused to follow the Fairbanks decision and held that the payment of bonds at maturity by an issuing corporation did constitute a "sale or exchange" of capital assets and that the bondholder was entitled to the benefit of the remedial rate of 12½% on the capital gains.

The decision in the *Averill* case is in direct conflict with the decision of the Ninth Circuit Court of Appeals in the present case. In view of this conflict and for the reasons set forth in the petition for rehearing it is respectfully submitted that petitioner's motion for leave to file a petition for rehearing and for an order vacating the order of this Honorable Court, dated October 10, 1938, denying the petition for a writ of certiorari herein should be granted.

On October 18, 1938, the mandate of the United States Circuit Court of Appeals for the Ninth Circuit was issued in the present case. Thereafter counsel for the United States of America prepared a final judgment for entry by the United States District Court for the Southern District of California, Central Division, and has forwarded said judgment to counsel for petitioner for approval. The matter is now pending before the United States District Court for the Southern District of California, Central Division, for entry of such final judgment.

The collection of the taxes herein involved amounting to $72,186.94 with interest at 6% per annum from January 26, 1932, in the sum of approximately $30,000, making a total of $102,186.94, is not in jeopardy for the reason that your petitioner has filed with the United States District Court for the Southern District of California, Central Division, a bond in the amount of $100,000, the amount of the said bond having been agreed to and approved by counsel for respondent on review. In addition, Douglas Fairbanks is of sufficient means to respond amply to the amount of said judgment in excess of the bond.

Your petitioner is informed and believes that if final judgment be entered by the United States District Court for the Southern District of California, Central Division, and collection made thereon, it will forever bar your petitioner from relief, even though this Honorable Court should subsequently reverse the decision of the Circuit Court of Appeals for the Ninth Circuit.

Pending the decision in the case of *Frances M. Averill* v. *Commissioner* and on December 20, 1938, your petitioner made application to the Circuit Court of Appeals for the Ninth Circuit requesting that that Court stay the entry of the judgment in the instant case until February 12, 1939, and for an order recalling the mandate of that Court heretofore issued on October 18, 1938. On December 22, 1938, the Circuit Court of Appeals for the Ninth Circuit denied petitioner's motion. Therefore, unless relief is granted by this Honorable Court, your petitioner respectfully submits that he will be forever barred from obtaining relief.

As a precedent for the within application, your petitioner respectfully relies upon the order entered by this Honorable Court in *Robert G. Stone and Carrie M. Stone, Trustees under the Will of Galen L. Stone* v. *Thomas W. White, Former Collector of Internal Revenue at Boston, Massachusetts.* Case No. 202, October Term, 1935.

WHEREFORE, it is prayed that the relief sought by these motions be granted.

Respectfully submitted,

ARTHUR F. DRISCOLL,
Counsel for Petitioner.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1937.

No. 1069.

DOUGLAS FAIRBANKS,
Petitioner,

against

UNITED STATES OF AMERICA,
Respondent.

PETITION FOR REHEARING OF DENIAL OF PETITION FOR CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT.

To the Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States:

COMES NOW YOUR PETITIONER, Douglas Fairbanks, and presents this petition for a rehearing of the petition for certiorari in this case.

Jurisdiction.

The petition for certiorari in this case was filed on May 28, 1938 and the petition was denied by this Honorable Court on October 10, 1938.

Reasons for Petition for Rehearing.

On December 28, 1938 (opinion filed January 6, 1939) the Circuit Court of Appeals for the First Circuit rendered a decision in the case of *Frances M. Averill* v. *Commissioner of Internal Revenue*, which is in square conflict with the decision of the Circuit Court of Appeals for the Ninth Circuit in the instant case.

In addition this case presents an important question of the law of federal income taxation which has never been passed upon by this Honorable Court. The specific questions at issue are:

> 1. Does the redemption of bonds by an issuing corporation before maturity constitute *a sale or exchange of capital assets* as to the owner and holder of the bonds, within the meaning of Section 208(A)(1) of the Revenue Act of 1926 and Section 101(C)(1) of the Revenue Act of 1928.
>
> 2. Does the gain realized by the bondholder constitute (a) capital gain from the sale or exchange of a capital asset taxable at the 12½% rate; or (b) ordinary income taxable at both normal and surtax rates.

In the instant case the Circuit Court of Appeals for the Ninth Circuit held that the redemption of such bonds prior to maturity did not constitute a "sale or exchange" of capital assets within the meaning of the above cited provisions of the Revenue Acts, stating in its opinion (Record, pp. 135, 136):

> "By §§208(a)(1) and 101(c)(1) the term 'capital gain' is defined as meaning 'taxable gain from the sale or exchange of capital assets consummated after December 31, 1921.' It is conceded that the bonds in question were capital assets, and that they were redeemed after December 31, 1921. The question is whether such redemption constituted a 'sale or exchange' of the bonds, within the meaning of §§208(a)(1) and 101(c)(1).

> "We think not. Between the *redemption* of a bond and the *sale or exchange* thereof, there is a clear distinction. Such redemption is merely the payment of an obligation according to its terms. It is in no wise a sale or exchange. Watson v. Commissioner, 27 B.T.A. 463, 465; Braun v. Commissioner, 29 B.T.A. 1161, 1177."

In the *Averill* case the Circuit Court of Appeals for the First Circuit had before it for decision among other things, the question of whether the payment at maturity of bonds constituted a "sale or exchange" of capital assets within the meaning of Section 101(c)(1) of the Revenue Act of 1928, so as to afford Mrs. Averill the use of the remedial 12½% tax rate on capital gain. The *Averill* case was argued before the said First Circuit Court of Appeals after October 10, 1938 after the decision in the instant case and the decision of the Ninth Circuit Court of Appeals in the instant case was fully briefed to the Court, and the said Court was advised orally of the denial of certiorari by this Honorable Court.

The First Circuit Court of Appeals as regards the problem of taxation, refused to consider any distinction between bonds called for redemption prior to maturity and bonds paid at maturity, thus clearly indicating as had every court passing on this question, as well as the Commissioner of Internal Revenue in his rulings, that an identical legal problem is present in both instances.

See:

Henry P. Werner, 15 B.T.A. 482;
John H. Watson, Jr. 27 B.T.A. 463;
Ernest W. Brown, 36 B.T.A. 178;
Felin v. *Kyle*, 22 Fed. Supp. 566;
IT 1637 II-1 C.B. 36;
IT 2488 VIII-2 C.B. 127;
IT 2678 XII, 1 C.B. 117.

The Circuit Court of Appeals for the First Circuit then studied the legislative history of the *capital gain and loss*

provisions of the Revenue Acts, from their original inclusion in the Revenue Act of 1921, and determined that the payment of bonds at maturity constitutes a "sale or exchange" of capital assets entitling the holder thereof to have her gains thereon taxed at the remedial rate of 12½%. This decision is in complete conflict with the decision of the Ninth Circuit Court of Appeals in the instant case.

For the convenience of this Honorable Court the entire opinion in the *Averill* case is reprinted herein as Appendix "A" and the opinion of the Ninth Circuit Court of Appeals in the instant case (93 Fed. 2d 794) is reprinted herein as Appendix "B".

In addition to the above reasons for rehearing, your petitioner respectfully refers this Honorable Court to his original petition filed herein to demonstrate the following additional grounds for the granting of a writ of certiorari:

(a) The Ninth Circuit Court of Appeals had decided an important question of Federal law which has not been, but should be, settled by this Court and in a way probably in conflict with applicable decisions of this Court on similar problems arising under the same provisions of the Revenue Act.

(b) A final decision by this Court will settle much pending litigation and eliminate further litigation.

Your petitioner also wishes to point out to this Court that there is presently pending before the United States Board of Tax Appeals a proceeding entitled "Douglas Fairbanks vs. Commissioner of Internal Revenue", Docket No. 95287, involving the identically same question for the calendar year 1930 and involving additional income taxes, attributable to this question, in the sum of $87,283.01. A final decision in this matter would, of course, be controlling in that litigation.

Taxation being based upon principles of equity, it seems manifestly unjust that the fact of Fairbanks' residence

within the jurisdiction of the Ninth Circuit Court of Appeals should subject him to a liability for tax and interest exceeding $200,000 while a resident within the jurisdiction of the Circuit Court of Appeals for the First Circuit should be absolved of income taxes, on a set of facts exactly identical in their legal effect.

WHEREFORE petitioner respectfully submits,

(1) That this petition for rehearing of its petition for certiorari be granted; and

(2) That an order enter vacating the order of this Honorable Court dated October 10, 1938 denying the petition for certiorari herein.

Respectfully submitted,

ARTHUR F. DRISCOLL,
Counsel for Petitioner.

I, ARTHUR F. DRISCOLL, counsel for petitioner, certify that the foregoing motions for leave to file a petition for rehearing, for an order vacating the order of this Court dated October 10, 1938, denying the petition for certiorari herein, for an order staying the entry of judgment in the instant case in the United States District Court for the Southern District of California, Central Division, and this petition for Re-hearing are presented in good faith and not for the purpose of delay.

ARTHUR F. DRISCOLL

APPENDIX A.

UNITED STATES CIRCUIT COURT OF APPEALS

FOR THE FIRST CIRCUIT

OCTOBER TERM, 1938.

FRANCES M. AVERILL, *Petitioner for Review,* v. COMMISSIONER OF INTERNAL REVENUE.	No. 3376.

PETITION FOR REVIEW OF A DECISION OF THE UNITED STATES BOARD OF TAX APPEALS.

BEFORE BINGHAM, WILSON AND MCLELLAN, JJ.

Opinion of the Court.
December 28, 1938.

MCLELLAN, J. This petition to review a decision of the Board of Tax Appeals presents the question whether the gain realized by the petitioner when bonds owned by her were paid at maturity in 1931 should be taxed as ordinary income. The Board decided that such gain should be taxed as ordinary income; the petitioner urges that it should be taxed as capital gain at the maximum rate of 12½ per cent. The Board erred and the petitioner should prevail:

1. If a transaction in 1927 in which she parted with some stock and received cash and bonds was a sale for a price payable by installments and not as to her a statutory reorganization; or

2. If, though the 1927 transaction was not a sale, the 1931 surrender of her bonds then maturing for which she received payment was a "sale or exchange" within the meaning of the Revenue Act of 1928.

The reason the petitioner should prevail if she sold her stock in 1927 is that the rights of the parties would then be governed by a statute permitting the taxpayer who sells or otherwise disposes of property on the installment plan to return as income in any taxable year that portion of the installment payments actually received in that year which the total profit realized or to be realized when the payment is completed bears to the total contract price (Revenue Act of 1926, Section 212(d)), and by a statute giving the taxpayer in case of a capital net gain an election to pay a 12½ per cent tax thereon (Revenue Act of 1928, Section 101(a)). The reason the petitioner should prevail if the transaction by which she gave up her bonds and received payment therefor in 1931 constituted a sale or exchange of the bonds is that in such a case the statute last cited gives the taxpayer an option to pay a 12½ per cent tax on a capital gain, which Section 101(c) of the Revenue Act of 1928 defines as "a taxable gain from the sale or exchange of capital assets."

We proceed to state the facts material to these two questions.

For more than two years prior to January 1, 1927, the petitioner had owned 1500 shares of the common stock of Keyes Fiber Company, hereafter sometimes called the old company. This corporation at all times here material had outstanding but one issue of stock—its common stock, of which there were 6000 shares.

On July 27, 1927, the petitioner, her husband George S. Averill and other shareholders representing in all 5912 shares, entered into a contract with the Rex Pulp Products Company, hereinafter called Rex. In this contract the shareholders of the old company, refered to therein as "the vendors," agreed to "sell, assign and convey all the shares owned by them to a new corporation to be organized under the laws of Maine, hereinafter known as the vendee, to be called Keyes Fiber Company, Inc., or some similar name, at the agreed purchase price of seven hundred fifty (750) dollars per share." Rex agreed "that it will cause the vendee to pay to each of said vendors on or before the 11th day of August, 1927, at the Fidelity Trust Company, Portland, Maine, for the num-

ber of shares of stock in said company which said vendors shall properly deliver to the order of the vendee at the Fidelity Trust Company, Portland, Maine, the sum of seven hundred fifty (750) dollars per share." Rex also agreed that "such payments shall be made as follows, viz: 5/9 (five ninths) of the purchase price for said shares shall be paid in the first mortgage bonds of the vendee and the remaining 4/9 (four ninths) of such price shall be paid in cash." It was further agreed that the proportion of bonds and cash paid to the individual vendors should be as agreed upon among themselves. The contract provided in substance that the first mortgage bonds should constitute a first lien on all the property "now or hereafter acquired" by either the old company, or Rex, or the corporation to be organized.

Later, Keyes Fiber Company, Inc., hereafter sometimes called the new company, was organized. On August 11, 1927, certain corporate votes were passed by the old Company, Rex, and the new company. The new company first acquired all the assets of Rex in exchange for its own common stock. It then assumed those obligations which the contract of July 27 provided that it should assume, and voted to purchase the 5912 shares of the old company as provided in the contract. The stock of the old company was then assigned to the new company, which immediately pledged it to a trustee as security for the performance of its obligations under the contract. The old company then conveyed all its assets to the new company for the agreed price of $4,500,000, and this sum was paid to it by the new company, 4/9s in cash and 5/9ths in bonds. The old company then made a liquidating dividend to its stockholders of $750 a share, 4/9ths in cash and 5/9ths in bonds, and was later dissolved. This dividend was received by the new company as holder of the stock of the old company, and was immediately transferred to the former stockholders of the old company in exchange for their stock, in accordance with the terms of the contract of July 27 and of the pledge to the trustee. While, as heretofore stated, the contract of July 27, 1927 provided that the purchase price of the stock should be paid 5/9ths in bonds of the vendee and

4/9s in cash, there was a provision that "the proportion of payment of bonds and cash should be such as is agreed upon among said vendors." Accordingly, the petitioner received $275,000 cash, which was just less than 25 per cent of the purchase price, and $850,000 in serial bonds which were of the par value of $1,000 cash and worth par when received in 1927. One tenth of the petitioner's 850 bonds matured in each of the years 1931 to 1936 inclusive and four tenths in 1937.

At all material times up to August 11, 1927, the date on which the petitioner disposed of her stock in the old company, her husband, Dr. George G. Averill, was a large stockholder, a director, treasurer and clerk of the old company. The petitioner held no office in the old company. Neither Dr. nor Mrs. Averill held any office in Rex Pulp Products Company or the new company at any time, nor did either of them hold any office in the old company at any time after the petitioner disposed of her stock. Thus it appears that so far as the petitioner is concerned all she did was to transfer her stock in the old company for cash and serial bonds of the transferee.

As heretofore indicated, the first question is whether the transaction in 1927 was tantamount to a sale by the taxpayer of her corporate stock for a price to be paid in installments.

The Board decided and the Commissioner contends that it was not a sale but an exchange by a party to a reorganization of stock in a corporation for securities in another corporation in pursuance of the plan of reorganization. Some of the essentials of a statutory reorganization inhered in what was done in 1927. These we think it unnecessary to discuss in detail. That the corporate bonds may be deemed "securities" within the meaning of the reorganization provisions of the statute is settled by *Helvering* v. *Watts*, 296 U. S. 387, where the Supreme Court said: "The bonds, we think, were securities within the definition, and cannot be regarded as cash, as were the short term notes referred to in *Pinellas Ice and Cold Storage Company* v. *Commissioner*, 287 U. S. 462." The decision that the bonds there involved "were securities within the definition, and cannot be regarded as cash" is referable to

a contract where no sale but only an exchange for stock and bonds was intended. An inspection of the contract in that case, appearing in 28 B. T. A. 1056, shows that the parties contemplated no sale, but only an exchange of stock for stock and bonds. Consistent with the rest of the contract are the clauses reading:

> "Whereas, said Parker Sloane is exchanging and delivering to and with the Vanadium Corporation of America Thirty Thousand (30,000) shares of the stock of the United States Ferro Alloys Corporation, * * * and
>
> "Whereas, the Vanadium Corporation of America is exchanging and delivering to said Parker Sloane, Trustee for the owners of said United States Ferro Alloys Corporation" (certain shares of stock together with certain bonds).

We understand the Watts case as holding that bonds may be deemed securities, and that if treated as such, they cannot be regarded as cash. It does not indicate that where, as in the case at bar, a person expresses his intention to sell and another to buy corporate stock and both parties contemplate a sale for a price payable by installments, that the transaction loses its character as such just because the vendee's obligation is represented in part by serial bonds. Neither does the Watts case nor, so far as we know, any other decision of the Supreme Court of the United States, decide that the ownership of bonds without stock ever constitutes such a continuing interest as is essential to a statutory reorganization, a question which we are not called upon to decide. *Cf. Worcester Salt Company* v. *Commissioner*, 75 Fed. (2d) 251 (C. C. A. 2d) and *Lilienthal* v. *Commissioner*, 80 Fed. (2d) 411 (C. C. A. 9th).

The instant case discloses that the taxpayer contracted to sell her stock at $750 a share and the new corporation undertook to buy it at that price. The total price was to be paid, as to about 25 per cent thereof, in cash and the balance over a

period of years. The petitioner's husband then relinquished his connections with the old company and had nothing to do with the management of the new one. Both intended to get out of the business and the new company intended that they should. The substance of the transaction was a sale by installments and the serial bonds were treated merely as a convenient method of providing for the installment payments. We see no adequate reason for saying that the intention of the parties should not be given effect. As to the taxpayer, the transaction amounted to a sale of her stock, not an exchange "by a party to a reorganization of stock in a corporation for securities in another corporation, a party to the reorganization, in pursuance of the plan of reorganization."

As before stated the taxpayer sold her stock in 1927 for a price payable in installments. Within the meaning of the statute she did not exchange it for securities in another corporation. The sale was casual, the purchase price exceeded $1,000 and the initial payment received in cash other than evidences of indebtedness of the purchaser during the year in which the sale was made and did not exceed one-quarter of the purchase price. In short, the transaction was within Section 212 of the Revenue Act of 1926, which permits the return in any taxable year of "that proportion of the installment payments actually received in that year which the total profit realized or to be realized when the payment is completed bears to the whole contract price."

In her tax return for 1927 the petitioner reported gains from the disposition of her stock upon the installment basis and upon that basis her income tax for that year was paid. The Commissioner made no adjustment of the tax as to the petitioner, though he "disallowed the use of the installment basis as to Dr. George G. Averill and computed the gain under the reorganization exchange provisions." In the position then taken by the taxpayer she was right. Collection of the serial bonds falling due in 1931, with which we are here concerned, involved a net gain which, by virtue of Section 101 of the Revenue Act of 1928, is taxable at 12½ per cent.

We now come to a different question. If the 1927 transaction were governed by the statutory reorganization provisions, it would not follow necessarily that the Board's decision is correct. When in 1931 the taxpayer surrendered her bonds then maturing and received payment therefor, she realized a gain over their stipulated cost. Her right to treat this profit as a capital gain taxable at the rate of 12½ per cent depends upon the portions of the Revenue Act of 1928 which follows:

> SEC. 101. CAPITAL NET GAINS AND LOSSES.
>
> (a) Tax in case of capital net gain.—In the case of any taxpayer, other than a corporation, who for any taxable year derives a capital net gain (as hereinafter defined in this section), there shall, at the election of the taxpayer, be levied, collected, and paid, in lieu of all other taxes imposed by this title, a tax determined as follows: a partial tax shall first be computed upon the basis of the ordinary net income at the rates and in the manner as if this section had not been enacted and the total tax shall be this amount plus 12½ per centum of the capital net gain.
>
> (c) Definitions.—For the purposes of this title—
>
> (1) "Capital gain" means taxable gain from the sale or exchange of capital assets.
>
> * * * * * *
>
> (7) "Ordinary net income" means the net income, computed in accordance with the provisions of this title, after excluding all items of capital gain, capital loss, and capital deductions.
>
> (8) "Capital assets" means property held by the taxpayer for more than two years * * *

At the outset we are confronted with the question whether it is so clear that the words "taxable gain from the sale or exchange of capital assets" do not include a transaction whereby bonds are redeemed at maturity that we are not per-

mitted to use the canons of interpretation commonly used where the question is fairly debatable. If it were true that in the very nature of things a covenantee cannot sell a bond or other specialty to the covenantor, this would tend to support the Board's decision. But we think the holder can sell the bond to anybody. The incidents of such sales vary. If the bond is sold to a stranger, he gets it and with it the right to enforce it. If an attempted sale is made to the covenantor, he gets the bond though he acquires no right to enforce it. Perhaps one way to put it is that in either case there is a sale or transfer of title for a price—that in one case the subject matter of the sale is the bond as a valid obligation, and that in the other case the subject matter of the sale is the bond as something calculated no longer to represent contractual rights. It makes no difference whether the transaction is regarded as the sale of a contract right to a stranger or as a sale of a "piece of paper" to the covenantor. In either case the original holder may be regarded as having realized a gain from the sale of a specialty.

In prior decisions and in the case at bar the Board adheres to the view that preferred stock may be sold to the corporation which issued it. *Helvering* v. *Schoellkopf*, recently decided by the Second Circuit and not yet reported, indicates that within the meaning of the reorganization statute a corporation's own shares cannot be regarded as "property acquired" by it. But we find nothing there requiring the conclusion that a bond, particularly in a state where the distinction between sealed and unsealed instruments has not been abolished, cannot be sold to its maker.

Moreover, a trasaction whereby a holder surrenders his bond and receives payment thereof or therefor has commonly been called a redemption, which derivatively and according to the dictionaries, and Judge Wilson's opinion while Chief Justice of the Maine Supreme Court, is a repurchase. *Bernstein* v. *Blumenthal*, 127 Me. 393, 396.

We think the proper construction of the words "taxable gain from the sale or exchange of capital assets" sufficiently debatable to warrant a brief reference to the history of this clause of the statute.

The first legislation according special treatment to capital gains is in the Revenue Act of 1921. There the definition of capital gain as "taxable gain from the sale or exchange of capital assets" first appeared. It reappeared in the intervening Acts and that of 1932. Referring to the purpose of the Congress in passing the Revenue Act of 1921, the Supreme Court of the United States in *Burnet* v. *Harmel*, 287 U. S. 103, 106, said:

> "* * * The provisions of the 1921 Revenue Act for taxing capital gains at a lower rate, re-enacted in 1924 without material change, were adopted to relieve the taxpayer from these excessive tax burdens on gains resulting from a conversion of capital investments, and to remove the deterrent effect of those burdens on such conversions."

Prior to the Revenue Act of 1928, here applicable, the practice had been to treat gains incident to the redemption of bonds as ordinary income. The tendency of the use of the same language in the 1928 Act was to indicate a congressional intent to the same effect. But after the 1928 Act was passed there was a series of events pointing another way.

In *Werner* v. *Commissioner*, 15 B. T. A. 482, the Board of Tax Appeals in 1929 recited the legislative history of the statutory definition now under consideration and concluded that the redemption of "called" bonds constituted a "sale or exchange." It may be stated parenthetically that no importance was attributed to the fact that the bonds were "called" and we do not see how that fact is of consequence. After this decision by the Board, the Commissioner in IT : 2488 (2 C. B. 127) revoked his previous ruling and directed that the net gains from bonds held for more than two years received as a result of the maturity of the bonds or as a result of their redemption before maturity may, at the option of the taxpayer, other than a corporation, be taxed under the capital gains section of the Revenue Act of 1921. This ruling was also made applicable to the Revenue Acts of 1924, 1926, and 1928. As stated in the petitioner's brief, "thus, from 1929

until December 1932, the ruling of the administrative department of the Government in charge of the collection of income taxes, as well as the ruling of the Board, interpreted the statute in accord with the petitioner's contention." In the light of this interpretation, Congress in 1932 reenacted its definition of "capital gain" in precisely the same language. Unless the Werner case was plainly erroneous, and we do not think it was, this reenactment of the statute might well be considered as a satisfactory interpretation of the legislative intent. *Buttolph* v. *Commissioner*, 29 Fed. (2d) 695 (C. C. A. 7th, 1928). See also *Hassett* v. *Welch*, 303 U. S. 303.

On December 29, 1932, the Board of Tax Appeals reversed the Werner decision (*Watson* v. *Commissioner*, 27 B. T. A. 463). Thereafter, as shown in a publication of the Government Printing Office entitled "Revenue Revision, 1934, Hearing before the Committee on Ways and Means, House of Representatives, 73d Congress, Second Session, December 15 to 21, 1933 and January 9 to 11, 1934," the American Bar Association recommended that the Congress re-define the terms "capital gain" and "capital loss" to make clear whether such terms include gains and losses resulting from the redemption at maturity of capital assets. In the Revenue Act of 1934 it was provided:

> SEC. 117. CAPITAL GAINS AND LOSSES.
>
> (a) General Rule.—In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net income: (there follows a statement as to the percentages).

In subdivision (f) of the same section it was provided that "for the purposes of this title, amounts received by the holder upon the retirement of bonds, debentures, notes, or certificates or other evidences of indebtedness issued by any corporation * * * shall be considered as amounts received in exchange therefor."

There seem to us two admissible views as to the bearing of this legislation, one that it constitutes a legislative declaration of the meaning of the word "exchange" and governs the construction of the word in prior Acts, the other the view expressed by the Circuit Court of Appeals for the 9th Circuit in the following language:

> "When Congress determined, as it did in 1934, to treat as 'capital gains' gains resulting from the retirement of bonds issued by a government or corporation, it had no difficulty in expressing its intent in clear and unambiguous language. Revenue Act of 1934, Sec. 117 (f), 48 Stat. 715, 26 U. S. C. A. Sec. 101 (f). If such intent had existed prior to 1934, it could and, we think, would have found similar expression."
>
> *United States* v. *Fairbanks*, 95 Fed. (2d) 794, 796.

Though the question seems to us a close one, we think under all the circumstances that the doctrine enunciated by Chief Justice Marshall in *Alexander* v. *The Mayor of Alexandria*, 5 Cranch 1, is here relevant. He there said:

> "Without deciding this question as depending merely on the original law, it is to be observed that acts *in pari materia* are to be construed together as forming one act. If in a subsequent clause of the same act provisions are introduced, which show the sense in which the legislature employed doubtful phrases previously used, that sense is to be adopted in construing those phrases. Consequently, if a subsequent act on the same subject affords complete demonstration of the legislative sense of its own language the rule which has been stated, requiring that the subsequent should be incorporated into the foregoing act, is a direction to courts in expounding the provisions of the law."

This language is quoted in full in this court's opinion in *Panther Rubber Co.* v. *Commissioner*, 45 Fed. (2) 314, where Judge Wilson also said:

"Congress, by substitute provisions, *in pari materia* with section 250 of the Revenue Act of 1921, has indicated that such was its intent, and has made it clear in the act of 1924 and especially in the Revenue Act of 1928. In the Revenue Act of 1924, Sec. 278 (c), Congress provided that assessment and collection may be had after the expiration of the statutory period, where the taxpayer and commissioner, 'have consented,' indicating a past act. This might not be conclusive, but Congress in the Revenue Act of 1928 clearly indicated its intent (see chapter 852, Sec. 276 (26 U. S. C. A. Sec. 2276)), and required the waiver to be signed before the limitation period for assessing the tax expired."

See also:

Old Colony Trust Company v. *Malley*, 19 Fed. (2d) 346.

We think the taxpayer's 1931 gain not taxable as ordinary income, but as capital gain at the maximum rate of 12½ per cent because the 1927 transaction was a sale for a price payable in installments not affected by the reorganization provisions of the statute, and because, if this is not so, the redemption of her bonds in 1931 resulted in a "capital gain" within the meaning of the statutory definition of that term.

The decision or order of the Board of Tax Appeals is reversed and the case is remanded to that Board for further proceedings not inconsistent with this opinion.

APPENDIX B.

IN THE

UNITED STATES CIRCUIT COURT OF APPEALS

FOR THE NINTH CIRCUIT.

UNITED STATES OF AMERICA, Appellant, vs. DOUGLAS FAIRBANKS, Appellee.	No. 8444 Apr. 2. 1938
DOUGLAS FAIRBANKS, Appellant, vs. UNITED STATES OF AMERICA, Appellee.	

Upon Appeals from the District Court of the United States for the Southern District of California, Central Division.

Before GARRECHT, MATHEWS and HANEY, *Circuit Judges*.

MATHEWS, Circuit Judge:

The United States (hereafter called plaintiff) brought this action against Douglas Fairbanks (hereafter called defendant) to recover amounts aggregating $72,186.24 claimed to have been erroneously refunded to defendant on account of alleged overpayments of income taxes for 1927, 1928 and

1929, with 6% interest from the date of refund, January 26, 1932. The case was tried by the court without a jury, trial by jury having been expressly waived. The court made and filed special findings of fact and thereupon entered judgment in favor of plaintiff for the principal sum claimed, with 7% interest from the date (July 6, 1933) on which payment had been demanded of defendant. Both parties have appealed, plaintiff claiming that interest should have been allowed from the date of refund, defendant claiming that judgment should have been entered in his favor.

The action was brought under §610(b) of the Revenue Act of 1928, 45 Stat. 875, 26 U. S. C. A., §1646(b), which provides: "Any portion of an internal revenue tax (or any interest, penalty, additional amount, or addition to such tax) which has been erroneously refunded * * * may be recovered by suit brought in the name of the United States, but only if such suit is begun before the expiration of two years after the making of such refund."

Section 1104 of the Revenue Act of 1932, 47 Stat. 287, 26 U. S. C. A., §1670(a)(3), provides: "Where the Commissioner has (before or after June 6, 1932) signed a schedule of overassessments in respect of any internal revenue tax imposed by the Revenue Act of 1932, or any prior revenue Act, the date on which he first signed such schedule (if after May 28, 1928) shall be considered as the date of allowance of refund or credit in respect of such tax."

In this case, the schedule of overassessment was signed by the Commissioner on January 6, 1932. The refund check was delivered to the taxpayer on January 26, 1932. This suit was begun on January 20, 1934, more than two years after the signing of the schedule, but less than two years after the delivery of the refund check. Defendant contends that the two-year period specified in §610(b) begins to run upon allowance of the refund—that is to say, upon the signing of the schedule by the Commissioner—and that this action, therefore, was not commenced in time. There is no merit in this contention. The two-year period commences, not upon the allowance, but upon the actual making of the refund.

United States v. Wurts, ... U. S. ....., decided March 14, 1938.[1] This action was in time.

The trial court's findings of fact are not challenged. Facts found were as follows:

Defendant in 1925 became the owner and registered holder of debenture bonds of the Elton Corporation of the par value of $4,000,000, dated March 5, 1925, payable March 5, 1935. Each bond contained the following provision: "This debenture bond may be redeemed by the corporation at any time at its face value plus interest earned and unpaid hereon upon thirty days' notice to the registered holder thereof." In 1927, 1928 and 1929, the corporation did so redeem bonds held by defendant, of the aggregate par value of $1,900,000, and defendant realized therefrom a taxable gain.

The question now to be decided is whether the gain so realized by defendant was a "capital gain," within the meaning of §208(a)(1) of the Revenue Act of 1926, 44 Stat. 19, and §101(c)(1) of the Revenue Act of 1928, 45 Stat. 811. If so, it was taxable at the rate of 12½%.[2] If not, it was taxable at the higher (normal and surtax) rates[3] applicable to other income of defendant for the taxable years in question.

By §§208(a)1(c) and 101(c)(1) the term "capital gain" is defined as meaning "taxable gain from the sale or exchange of capital assets consummated after December 31, 1921." It is conceded that the bonds in question were capital assets, and that they were redeemed after December 31, 1921. The question is whether such redemption constituted a "sale or exchange" of the bonds, within the meaning of §§208(a)(1) and 101(c)(1).

We think not. Between the *redemption* of a bond and the ***sale or exchange*** thereof, there is a clear distinction. Such redemption is merely the payment of an obligation according

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[1] Reversing United States v. Wurts (C. C. A. 3), 91 F. (2d) 547, cited by defendant.

[2] Revenue Act of 1926, §208(a)(1), 44 Stat. 20; Revenue Act of 1928, §101(b), 45 Stat. 811.

[3] Revenue Act of 1926, §§210(a), 211(a), 44 Stat. 21; Revenue Act of 1928, §§11, 12(a), 45 Stat. 795, 796.

its terms. It is in no wise a sale or exchange. Watson v. ommissioner, 27 B. T. A. 463, 465;[4] Braun v. Commissioner, B. T. A. 1161, 1177.

First of the revenue acts according special treatment to pital gains was that of 1921. The above quoted definition "capital gain" is found in the 1921 and subsequent revenue ts to and including that of 1932. 42 Stat. 232, 43 Stat. 2, 44 Stat. 19, 45 Stat. 811, 47 Stat. 191. Defendant cites eport No. 350 of the House Ways and Means Committee and eport No. 275 of the Senate Finance Committee, accompanying the Revenue Bill of 1921, as indicating a purpose include in this definition gains resulting from the redemption of capital assets. We find in these reports no indication any such purpose. In Burnet v. Harmel, 287 U. S. 103, 6, cited by defendant, the court said:

> "Before the Act of 1921, gains realized from the sale of property were taxed at the same rates as other income, with the result that capital gains, often accruing over long periods of time, were taxed in the year of realization at the high rates resulting from their inclusion in the higher surtax brackets. The provisions of the 1921 revenue act for taxing capital gains at a lower rate, reenacted in 1924 without material change, were adopted to relieve the taxpayer from these excessive tax burdens on gains resulting from a conversion of capital investments, and to remove the deterrent effect of those burdens on such conversions. House Report No. 350, Ways and Means Committee, 67th Cong., 1st Sess. on the Revenue Bill of 1921, p. 10; see Alexander v. King, 46 F. (2d) 235."

Thus, it appears, the purpose of Congress in relieving the axpayer from "excessive tax burdens from gains resulting om a conversion of capital investments" was "to remove he deterrent effect of those burdens on such conversions." Conversions on which those burdens had a deterrent effect were sales and exchanges. Such burdens had, and have, no

[4] Overruling Werner v. Commissioner, 15 B. T. A. 482, cited by defendant.

deterrent effect on the redemption of bonds or other capi assets. This, doubtless, is the reason why, prior to 19 gains resulting from such redemption were never includ in the definition of "capital gain." Whatever the reas such gains were not so included, and the definition shou not, we think, be expanded by judicial construction.

When Congress determined, as it did in 1934, to treat "capital gains" gains resulting from the retirement of bon issued by a government or corporation, it had no difficulty expressing its intent in clear and unambiguous langua Revenue Act of 1934, §117(f), 48 Stat. 715. If such inte had existed prior to 1934, it could and, we think, would ha found similar expression.

In awarding judgment for the principal sum claimed, t trial court did not err. It erred to the prejudice of plaint in allowing interest from the date of demand only. It err to the prejudice of defendant in allowing interest at 7 Section 610(d) of the Revenue Act of 1928, as amended §805(a) of the Revenue Act of 1936, 49 Stat. 1744, provide "Erroneous refunds recoverable by suit under this sect shall bear interest at the rate of 6 per centum per annu from the date of the payment of the refund." In this ca therefore, 6% interest should have been allowed from Jan ary 26, 1932.

As to the principal sum awarded ($72,186.94), the jud ment is affirmed. As to interest, it is reversed and the ca is remanded, with directions to enter judgment in plaintif favor for 6% interest on said principal sum from Janua 26, 1932.

(Endorsed:) Opinion. Filed Apr. 2, 1938. Paul O'Brien, Clerk.

SUPREME COURT OF THE UNITED STATES.

No. 65.—October Term, 1938.

Douglas Fairbanks, Petitioner.
vs.
The United States of America.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Ninth Circuit.

[March 27, 1939.]

Mr. Justice McReynolds delivered the opinion of the Court.

Both courts below ruled that gain derived by the petitioner from redemption of bonds during 1927, 1928 and 1929 was not "capital gain" within the meaning of the controlling statutes.

No contest now exists concerning the facts. The narrow point as counsel agree is this—Must the redemption of bonds before maturity by the issuing corporation be treated as tantamount to a sale or exchange of capital assets within the meaning of section 208(a) (1), Revenue Act 1926, and section 101(c) (1), Revenue Act 1928.[1]

If redemption amounts to sale or exchange, the petitioner's gain was subject to taxation at the twelve and one-half per cent rate; otherwise, under normal and surtax rates.

Payment and discharge of a bond is neither sale nor exchange within the commonly accepted meaning of the words. The courts below found no sufficient reason for disregarding this and rightly applied the statutes under that view.

The Tax Acts of 1921, 1924, 1926, 1928 and 1932 contain like definitions of capital gain. From 1921 to 1929 the Commissioner held that such gain did not arise from redemption. In 1929 the Board of Tax Appeals held otherwise. *Werner* v. *Commissioner*, 15

[1] Revenue Act 1921 (November 23, 1921, c. 136, 42 Stat. 227, 232) provides—

"Sec. 206. (a) That for the purpose of this title:

(1) The term 'capital gain' means taxable gain from the sale or exchange of capital assets consummated after December 31, 1921:"

This provision without material change was reenacted by Revenue Act 1924 (June 2, 1924, c. 234, sec. 208(a)(1), 43 Stat. 253, 262); Revenue Act 1926 (February 26, 1926, c. 27, sec. 208(a)(1), 44 Stat. 9, 19); Revenue Act 1928 (May 29, 1928, c. 852, sec. 101(c)(1), 45 Stat. 791, 811); Revenue Act of 1932 (June 6, 1932, c. 209, sec. 101(c)(1), 47 Stat. 169, 191).

B. T. A. 482. But in 1932 it definitely overruled that determination. *Watson* v. *Commissioner*, 27 B. T. A. 463.

The Revenue Act 1934 (May 10, 1934, c 277, 48 Stat. 680, 714-715) provides—

"SEC. 117. CAPITAL GAINS AND LOSSES.

(a) General Rule.—In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net income: . . . . .

(f) Retirement of Bonds, Etc.—For the purposes of this title, amounts received by the holder upon the retirement of bonds, debentures, notes, or certificates or other evidences of indebtedness issued by any corporation (including those issued by a government or political subdivision thereof), with interest coupons or in registered form, shall be considered as amounts received in exchange therefor."

What we regard as the correct meaning of the definition of capital gain in the Revenue Act 1921 and its four successors is accentuated by long-continued executive construction, also the last conclusion of the Board of Tax Appeals.

The Circuit Court of Appeals below was right in holding that by the Act 1934 Congress did not attempt to construe the prior Acts and purposely made a material addition thereto. In *Averill* v. *Commissioner of Internal Revenue* (decided Dec. 28, 1938), the Circuit Court of Appeals First Circuit acted upon a different view. This conflict caused us to bring up the present cause notwithstanding the application for certiorari had been denied earlier in the term.

The challenged judgment must be

Affirmed.

A true copy.

Test:

Clerk, Supreme Court, U. S.